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No. 83-1961

In The
Supreme Court of the United States
October Term, 1984

Landreth Timber Company,
Petitioner,
v.

Ivan K. Landreth, Lucille Landreth,
Thomas E. Landreth, Ivan K. Landreth, Jr.,
and Kathleen Landreth,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF OF PETITIONER

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INTRODUCTION

This brief is submitted in reply to the brief of the respondents, and to the brief of the *amicus curiae* Advance Ross Corporation.

ARGUMENT

I. CONGRESS DID NOT INTEND THAT A SINGLE DEFINITION APPLY TO THE DISPARATE INSTRUMENTS LISTED IN THE DEFINITIONAL SECTIONS OF THE 1933 AND 1934 ACTS.

Central to the respondents' and *amicus* Advance Ross Corporation's ("ARC") arguments, and to the decision below, is the proposition that to fall within the definition of "security" every instrument must meet the test developed in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), to determine the existence of an investment contract. Respondents' Brief at 16-25; ARC Brief at 29; *Landreth Timber Company v. Landreth*, 731 F.2d 1348, 1352 (9th

Cir. 1984).[1] As we demonstrated in our opening brief at 24-35, neither the structure of the definitional sections of the Acts, 15 U.S.C. §§ 77b(1) and 78c(a)(10), well-settled canons of statutory construction, nor this Court's prior decisions permit the imposition of the test developed for " 'securities' of a more variable character, designated by such descriptive terms as . . . 'investment contract' " upon the definition of "the commonly known documents traded for speculation or investment." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 297 (1946). Indeed, adopting respondents' and ARC's argument that each instrument listed in the definitional sections must meet the investment contract test would be inconsistent with this Court's recognition in *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943), that the general terms such as "investment contract" were intended to expand, not to limit, the types of securities to which the Acts applied.[2]

Even the Seventh Circuit, the architect of the "sale of business doctrine," has concluded that the investment contract test cannot properly be applied to the other instruments listed in the definitional sections of the Acts. In *Hunssinger v. Rockford Business Credits, Inc.*, 745 F.2d 484, 492 (7th Cir. 1984), the Seventh Circuit rejected the argument that a note must meet the definition of an

[1] Specifically, the Ninth Circuit held "the sale of business doctrine and the risk capital test . . . include a transaction only if it involves 'an investment in a common enterprise with profits to come solely from the efforts of others,' " quoting *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946).

[2] *Amicus* ARC dismisses as "erroneous" the argument that its application of the "economic realities" or investment contract test to all categories of securities "would blur traditional differences between the categories of securiites enumerated by Congress." ARC Brief at 29. ARC asserts that even after the "economic realities" test is applied "each type of security retains its special attributes (*e.g.*, stocks are equity investments, bonds are secured debt investments, notes are unsecured debt investments, etc.) . . ." *Id.* Missing from that argument is any explanation of what difference those "special attributes" would make to the application of the securities laws, or why Congress would twice have bothered to list the securities possessing those special attributes.

investment contract to qualify as a "security." The court held:

> The investment contract test determines whether a particular instrument is an "investment contract," a distinct term in the definitional sections of the securities acts. An instrument that fails to satisfy all four requirements of the investment contract test may still fall under one of the other statutory terms in the definitional sections and hence be subject to the substantive provisions of the acts.

Hunssinger, 745 F.2d at 492.[3]

Not only do respondents err in asserting that the investment contract test should be applied to determine whether traditional common stock is a "security," but they also premise their argument on the untenable assertion that:

> The fact that a purchaser does not invest in a "common enterprise" with the seller in and of itself removes the transaction from the scope of the federal securities laws.

Respondents' Brief at 28. Application of such a purported requirement of a post-sale continuing "common enterprise" between purchaser and seller would substantially rewrite the securities laws. For example, it would exclude from the protection of the securities laws the garden variety transaction in which a shareholder employs a misrepresentation to sell all his stock in a corporation he never has controlled. After such a sale, there surely would be no "common enterprise" between the

[3] *Amicus* ARC also suggests that it is "well established that instruments which are securities when offered in an investment context cease to be securities when transferred in a commercial context." ARC Brief at 20. None of the cases it cites for this "well established" principle hold that the same instrument can be a security when issued, but lose that status when transferred. Furthermore, this Court has itself rejected such a variable treatment of a security. *See Marine Bank v. Weaver*, 455 U.S. 551, 559 n.9 (1982) ("We reject respondents' argument that the certificate of deposit was somehow transformed into a security when it was pledged, even though it was not a security when purchased.").

seller and his defrauded purchaser. Similarly, respondents' argument would exclude the promoter who sells in a public offering all the stock in his corporation. Again, after the successful offering there would be no continuing "common enterprise." Indeed, respondents' argument would exclude a successful tender for 100% of the stock of a publicly traded corporation because, again, there would be no continuing "common enterprise" between the purchaser and seller. Yet the Williams Act, 15 U.S.C. §§ 78*l*(i), 78m(d), 78m(e), 78n(d)-78n(f), was enacted to apply to just such transactions in "securities."

No argument which produces such illogical, and so clearly unintended, results should be permitted to alter the plain words of the definitional sections of the 1933 and 1934 Acts. The invitation to import the description of an investment contract into the definition of "stock" must be rejected.

II. NOTHING IN THE LEGISLATIVE HISTORY OF THE 1933 AND 1934 ACTS SUGGESTS THAT THE 1933 AND 1934 ACTS WERE PASSED FOR THE EXCLUSIVE BENEFIT OF "PASSIVE INVESTORS."

Respondents and ARC cull various passages of the legislative history of the 1933 and 1934 Acts to demonstrate that Congress was concerned with protecting "passive investors." Respondents' Brief at 13-15; ARC Brief at 15-18. They then leap to the unwarranted conclusion that Congress was *not* concerned with protecting any other class of persons who bought or sold securities. Indeed, ARC appears to assert that to find that Congress intended to protect non-passive investors would result in "an expansion of the scope of the federal securities laws —with an accompanying displacement of contractual remedies." [4] ARC Brief at 18.

[4] ARC's suggestion that rejecting the "sale of business doctrine" would *expand* the scope of the federal securities laws is curious. As we demonstrated in our opening brief, for more than forty-five years after the passage of the Acts no court had suggested that ordinary common stock was not a security. Petitioner's Brief at 24. The "sale of business" doctrine seeks to *restrict* that understanding of the scope of the federal securities laws. Rejection of the doctrine would, therefore, maintain the coverage of the Acts at their status prior to the doctrine's appearance.

ARC also devotes a substantial portion of its brief to the argument that permitting access to the protections of the securities laws would promote the breach of contractual obligations, including the "oppressive and unfair tactic" of "renouncing an express agreement to arbitrate." ARC Brief at 25. There is no agreement to arbitrate applicable here. Jt.A. 206-20. To the extent that any unfairness is worked by the holding in *Wilko v. Swan*, 346 U.S. 427 (1953), that the federal securities laws override an agreement to arbitrate, that "unfairness" exists in any case in which an agreement to arbitrate conflicts with the assertion of a claim under the securities laws. Moreover, only last week this Court ameliorated the "unfairness" of which ARC complains by holding that an agreement to arbitrate state law claims may be enforced even where those claims are pendent to a federal securities claim. *Dean Witter Reynolds, Inc. v. Byrd*, 53 U.S.L.W. 4222 (March 5, 1985).

That argument fails as a matter of logic and founders on the legislative history. To be sure, Congress desired to protect small, passive investors, and providing such protection was a major impetus for the Acts. But citation of a series of passages from the legislative history evidencing that intent does not suggest that Congress *rejected* the application of the securities laws to persons who were not small, passive investors. Instead, there is considerable evidence that Congress' intent was not so narrow as respondents and *amicus* assert. As this Court observed in *United States v. Naftalin*:

> While investor protection was a constant preoccupation of the legislators, the record is also replete with references to the desire to protect ethical businessmen. See 77 Cong. Rec. 2925 (1933) (remarks of Rep. Kelly); *id.*, at 2983 (remarks of Sen. Fletcher); *id.*, at 3232 (remarks of Sen. Norbeck); S. Rep. No. 47, 73d Cong. 1st Sess., 1 (1933). As Representative Chapman stated, "[t]his legislation is designed to protect not only the investing public but at the same time to protect honest corporate business." 77 Cong. Rec. 2935 (1933). Respondent's assertion that Con-

> gress' concern was limited to investors is thus manifestly inconsistent with the legislative history.

441 U.S. 768, 776 (1979).

In none of this Court's previous decisions is there any hint that it believed Congress intended to restrict the protections of the securities laws to "passive investors." *Cf.* Respondents' Brief at 12-15. To the contrary, the Court has unhesitatingly, and without dissent, applied the securities laws to transactions in which parties who were by no means "passive investors" were defrauded in connection with the purchase or sale of securities. *E.g.*, *Rubin v. United States,* 449 U.S. 424 (1981) (individually negotiated pledge of securities to bank); *United States v. Naftalin,* 441 U.S. 768 (1979) (fraud on brokers); *Superintendent of Insurance v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971) (fraudulent activities in connection with private transaction).

III. THE "SALE OF BUSINESS" DOCTRINE FINDS NO SUPPORT IN THE LOWER COURTS' APPLICATION OF THE INVESTMENT CONTRACT TEST TO GENERAL PARTNERSHIP INTERESTS.

Amicus ARC argues that the Ninth Circuit's decision finds "compelling support" in the analysis employed by some lower courts when considering whether a general partnership interest is a "security." According to ARC, the lower courts' application of the investment contract test to general partnership interests indicates that the test should be applied to a purchase of stock carrying with it some post-sale ability to influence the affairs of the corporation. To do otherwise, it asserts, "would create a serious anomaly under the federal securities laws and would blink at economic reality." ARC Brief at 18-19.

But the investment contract test has been applied to general partnership interests only because "general partnership interests" are not among the specific instruments listed in the definitional sections of the 1933 or 1934 Acts. Accordingly, if they are to qualify as "securities" they

must necessarily achieve coverage by meeting the test developed for the more variable form of "investment contract." Subjecting general partnership interests to the test applicable to the only category of securities into which they can fit—investment contracts—is hardly remarkable, nor does it provide support (compelling or otherwise) for applying the investment contract test to the separately enumerated instrument of stock. Indeed, the very complexity of the factual analysis employed by lower courts to determine whether a specific partnership interest in the hands of a specific partner is an "investment contract" compels the conclusion that the application of the securities laws to traditional common "stock" should not be permitted to depend upon such lengthy threshold inquiries. *See Williamson v. Tucker,* 645 F.2d 404, 417-26 (5th Cir. 1981) (considering whether partner could "exercise meaningful partnership powers," or whether partner is "so inexperienced" that he is "incapable of intelligently exercising his partnership . . . powers," or whether partner is dependent upon managerial ability of promoter or manager).

Moreover, no "anomaly" would be created by treating the acquisition of a general partnership interest differently from the acquisition of stock. In practically every area in which the law touches general partnerships and corporate entities, it treats them differently. A partner has unlimited personal liability for obligations of the partnership. The liability of a corporate shareholder is limited to his investment in his stock. A partner who sells his partnership interest remains liable on obligations accruing before the transfer, the seller of stock does not. *See* Uniform Partnership Act §§ 15, 29, 36. The general partner and the corporate shareholder also receive widely divergent treatment with respect to taxation, transferability of their interests, powers to manage the business, duties to co-owners and their ability to sue or be sued. Treating them differently under the securities laws does no more than recognize that they are distinct types of legal entities.

IV. THE SECURITIES AND EXCHANGE COMMISSION'S VIEWS ARE ENTITLED TO SUBSTANTIAL WEIGHT.

The views of an agency interpreting a statute under which it operates are entitled to "considerable weight." *United States v. National Association of Securities Dealers*, 422 U.S. 694, 719 (1975). *See also Saxbe v. Bustos*, 419 U.S. 65, 74 (1974); *Investment Company Institute v. Camp*, 401 U.S. 617, 626-27 (1971); *Udall v. Tallman*, 380 U.S. 1, 16 (1965). The Securities and Exchange Commission, in its *amicus* brief, has urged reversal of the decision below, asserting that persons who "purchase what is unquestionably stock should have the protection that investors reasonably expect to be associated with stock," that the "adoption of the analysis underlying the sale of business doctrine could adversely affect protection for those who purchase instruments other than stock, such as notes and debt instruments," and that "enforcement actions brought by the Commission" could be impaired. SEC *Amicus* Brief at 2-3.

Amicus ARC, itself a seller of stock seeking to avoid liability in another case, and respondents both seek to denigrate the views expressed by the Securities and Exchange Commission as an *amicus* supporting petitioner. ARC suggests that the arguments presented in the *amicus curiae* brief of the United States[5] in *Marine Bank v. Weaver*, 455 U.S. 551 (1982), conflict with arguments now made by the SEC in support of petitioner. ARC Brief at 26 n.6. ARC seeks to support this suggestion by taking quotations from the *Marine Bank* brief out of context and presenting them in a manner that seriously distorts the government's position in *Marine Bank*.

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[5] ARC mischaracterizes the *amicus* brief of the United States in *Marine Bank*, 455 U.S. 551 (1982), as the SEC's. But that brief was submitted on behalf of the United States and represented the composite views of the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency as well as those of the SEC.

Quoting from the *Marine Bank* brief, ARC contends, for example, that:

> The SEC acknowledged that it is necessary to look beyond the definitional language [of the statutes] "in those cases in which there is evidence that transactions of the type at issue were not intended to come within the scope of the statute."

ARC Brief at 26 n.6. ARC's quotation, however, omits the first part of the sentence, thereby effectively reversing its sense. The sentence in its entirety reads:

> The need to look beyond the statutory definitional language arises *only* in those cases in which there is evidence that transactions of the type at issue were not intended to come within the scope of the statute.

Brief for the United States as *Amicus Curiae* at 10 n.11 in *Marine Bank v. Weaver*, 455 U.S. 551 (1982) (hereinafter *Marine Bank* Brief) (emphasis supplied).

In fact the thrust of the government's argument in *Marine Bank* was almost directly the opposite of what is attributed to it by ARC. The passage from which ARC severed the above quotation asserts (as the SEC continues to assert here) that, as to those conventional financial instruments explicitly listed in the statutory definition (such as stock), the plain language of the statute should apply:

> We do not suggest that in all cases federal courts need sift the circumstances surrounding a transaction to form an ad hoc opinion on whether the transaction is subject to the federal securities laws. *The comprehensive and carefully prescribed definitions in the securities laws ordinarily apply at face value, and generally are themselves a safe guide to congressional intent.*

Marine Bank Brief at 10 n.11 (emphasis supplied).

ARC further distorts the government's position in *Marine Bank* by failing to mention that a separate contemporaneously passed regulatory scheme existed for the

bank certificates of deposit involved there. The dominant theme of the government's brief was that, "The protection afforded by this comprehensive scheme of regulation substantially eliminates the need for application of the antifraud provisions of the securities laws." *Marine Bank* Brief at 6. The government argued, as ARC points out, that it was "Congress' intent to avoid regulating those 'types of securities and securities transactions where there is no practical need for [the statute's] application or where the public benefits are too remote.'" ARC Brief at 26 n.6. But the government based its conclusion as to Congress' intent to avoid redundant federal regulation on the fact that the banking industry "already is subject to pervasive regulation to protect depositors," that to apply the securities laws to certificates of deposit would be "redundant" and that the legislative history of the Acts contained expressions that depositors in insured banks did not need the protection of the securities laws. *Marine Bank* Brief at 24.

Perhaps the most serious distortion of the government's *Marine Bank* brief is accomplished by ARC's substitution of "parties to commercial contracts" for "depositors" in the following adulterated "quotation" attributed to the *Marine Bank* brief:

> It was the interest of investors [as opposed to parties to commercial contracts] that required special protection under the securities laws.

ARC Brief at 26 n.6, quoting *Marine Bank* Brief at 18. The passage, as originally written, in no way relates to "parties to commercial contracts." Instead, the undistorted version of the quoted passage appeared in a discussion of the legislative history bearing on the treatment under the securities laws of "deposit instruments issued by commercial banks." *Marine Bank* Brief at 17. The dichotomy drawn in that discussion was not between investors and "parties to commercial contracts," but between investors and "depositors." The original passage actually reads:

> [T]here is evidence that, in considering the bill that became the Securities Exchange Act, Congress viewed the economic interests of *depositors* as being distinct from those of investors. It was the interest of investors that required special protection under the securities laws.

Id. at 18 (emphasis supplied).

Moreover, the government's *Marine Bank* brief did not, as ARC states, suggest there was a congressional "recognition that *persons in the position of the plaintiff*, on the one hand, and 'investors,' on the other, were properly 'viewed as standing in fundamentally different positions.'" ARC Brief at 26 n.6 (emphasis supplied). The passage selectively excerpted by ARC actually concludes, instead, that "investors and *depositors* were viewed as standing in fundamentally different positions." *Marine Bank* Brief at 18 (emphasis supplied).

The SEC has not, as ARC claims (ARC Brief at 26 n.6), abandoned the positions taken by the government in *Marine Bank*. ARC's distortion of those positions is both erroneous and—since an *amicus curiae* cannot file a reply brief to defend itself—unfair.

The respondents' brief echoes some of the distortions undertaken by ARC, suggesting that the SEC "recognized that the Acts were designed to help investors, not entrepreneurs such as the plaintiff in *Marine Bank*." Respondents' Brief at 36 n.28. Of course, the brief of the United States made no such recognition since it failed even to use the word "entrepreneur" and discussed only the distinction between depositors and investors. Accordingly, there is no reason for this Court to fail to accord to the Commission the deference to which the Court has long held an agency charged with administering a statute is entitled. *See United States v. National Association of Securities Dealers*, 422 U.S. 694, 719 (1975); *Saxbe v. Bustos*, 419 U.S. 65, 74 (1974).

CONCLUSION

For the reasons discussed above, and in our opening brief, the judgment of the Court of Appeals must be reversed, and the "sale of business doctrine" rejected.

Respectfully submitted,

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